2007-03085/

Department of Finance

News Release

Immediate release

Ottawa, October 31, 2006
2006-061

Canada's New Government Announces Tax Fairness Plan

The Honourable Jim Flaherty, Minister of Finance today announced a Tax Fairness Plan for Canadians. The plan will restore balance and fairness to the federal tax system by creating a level playing field between income trusts and corporations.

"The measures I am bringing forward today are necessary to restore balance and fairness to Canada's tax system, to ensure our economy continues to grow and prosper and to bring Canada in line with other jurisdictions," said Minister Flaherty. "Our plan is the result of months of careful consideration and evaluation. Our actions are clear, decisive and in the best interest of all Canadians."

For months there has been a growing trend toward corporate tax avoidance. Top Canadian companies, operating within the current rules, have announced their intention to convert to income trusts. They feel compelled to seek more favourable tax treatment by capitalizing on an available tax rule.

While these decisions offer corporations short-term tax benefits, they are creating an economic distortion that is threatening Canada's long-term economic growth and shifting any future tax burden onto hardworking individuals and families. If left unchecked, these corporate decisions would result in billions of dollars in less revenue for the federal government to invest in the priorities of Canadians, including more personal income tax relief. These decisions would also mean less revenue for the provinces and territories.

Canada stands alone in its treatment of income trusts. The structure being used in this country was shut down in the United States and Australia.

"The landscape has changed dramatically in the short time I have been Minister of Finance, and in fact, this year we have seen nearly $70 billion in new trust announcements," said Minister Flaherty. "The current situation is not right and is not fair. It is the responsibility of the Government of Canada to set our nation's tax policy, not corporate tax planners."

The measures in the Tax Fairness Plan include:

- A Distribution Tax on distributions from publicly traded income trusts and limited partnerships.

- A reduction in the general corporate income tax rate of one-half percentage point as of January 1, 2011.

- An increase in the Age Credit Amount by $1000 from $4,066 to $5,066 effective January 1, 2006. This will benefit low and middle-income seniors.

- A major positive change in tax policy for pensioners. The government will permit income splitting for pensioners beginning in 2007.

These measures represent a major tax reduction. Our Tax Fairness Plan will deliver over one billion dollars of new tax relief annually for Canadians.

For income trusts that begin trading after today, these measures will apply beginning with their 2007 taxation year. For existing income trusts and limited partnerships the government is proposing a four-year transition period. They will not be subject to the new measures until their 2011 taxation year.

"The time has come for Canada's New Government to act," said Minister Flaherty. "By introducing our Tax Fairness Plan today we are acting in the national interest, doing what's right for all Canadians, and significantly enhancing the incentives to save and invest for family retirement security."

The Tax Fairness Plan will build on the steps taken in Budget 2006. In that document Canada's New Government delivered significant tax relief for Canadians with 29 tax cuts amounting to $20 billion in tax relief over the next two years.

Additional details are available in the attached backgrounder or on the Department of Finance web site.

For further information, media may contact:

Dan Miles
Director of Communications
Office of the Minister of Finance
613-996-7861

David Gamble
Media Relations
Department of Finance
613-996-8080

www.fin.gc.ca

If you would like to receive automatic e-mail notification of all news releases, please visit the Department of Finance website at www.fin.gc.ca/scripts/register_e.asp

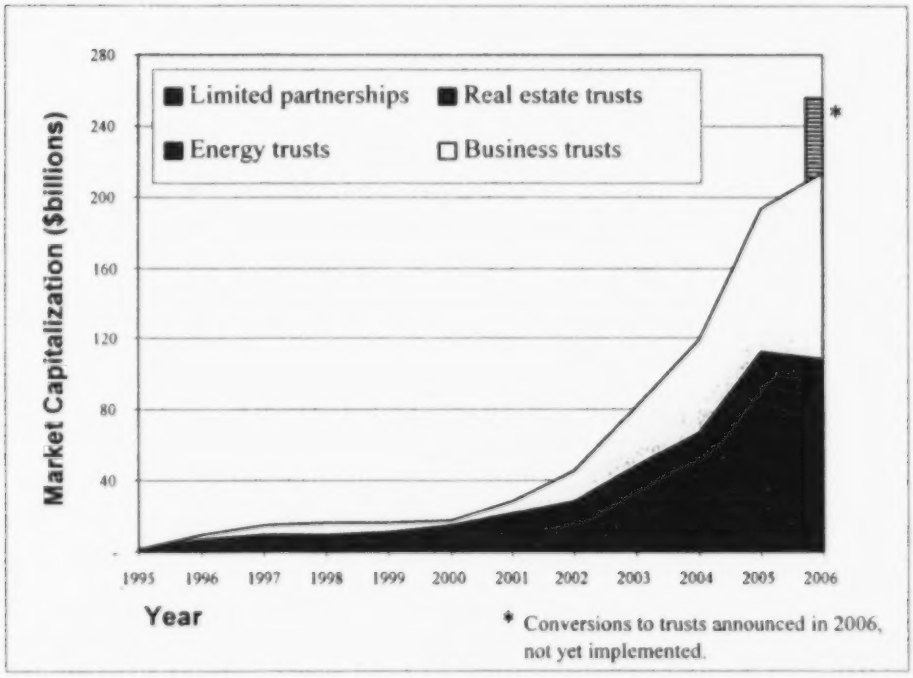
Backgrounder

The rapid growth of "income trusts"

"Income trusts" – or publicly-traded flow-through entities (FTEs)[1] – are an increasingly significant presence in Canadian business. As Chart 1 shows, these entities have grown dramatically over the past few years and now represent over $200 billion in market capitalization.

Despite the actions taken by the Government in the 2006 Budget to help address these issues, there is no indication that this trend will change: in 2006 alone, corporations representing almost $70 billion in market capitalization have either converted themselves into FTEs or announced plans to do so.

Chart 1: Market Capitalization of Publicly-Traded Canadian FTEs, 1995-2006 (as of October 20, 2006)



The cause: unbalanced tax treatment

A major reason for the proliferation of these entities – and a major reason for the concern they have generated – is the unbalanced income tax treatment that applies to them and their investors. In short, tax rules that were designed essentially for non-commercial and portfolio investment trusts (and for owner-operated partnership businesses) are being used by large-scale business entities that are widely held and publicly-traded, and the results are not appropriate.

---

[1] It is because they can flow income – and the associated tax liabilities – to their investors that trusts and partnerships are referred to as "flow-through entities" (FTEs). Many publicly-traded FTEs are business income trusts, and the term "income trusts" is sometimes used to refer to publicly-traded FTEs in general.

Non-residents and tax-exempts continue to benefit

Publicly-traded FTEs are in many respects not very different from business corporations. Their tax treatment, though, can be radically different. In particular, FTEs and their investors have enjoyed substantially lower combined income tax rates than large corporations and their shareholders. Until recently, this was the case where an FTE's investors were taxable Canadian-resident individuals. The combination of corporate income tax and the shareholder's tax on the dividend was significantly greater than the tax an otherwise identical investor would pay on income distributed by an FTE.

In its 2006 Budget the Government resolved this difference for those investors, by reducing the rate of federal tax on dividends from large Canadian corporations. Table 1 shows the result: with the 2006 change, taxable Canadian individuals face a total tax rate on FTE income that is the same as the rate on dividends from large Canadian corporations. This has eliminated much of the impetus for taxable Canadian residents to prefer FTE investments to investments in Canadian public companies.

However, Table 1 also indicates that non-residents (represented here by a taxable United States investor) and tax-exempt entities can obtain a sizable tax advantage if they invest in an FTE rather than a corporation.

Table 1: Simplified Comparison of Investor Tax Rates (current system)

Investor	FTE (Income)	Large Corporation (Dividend)
Taxable Canadian (*)	46%	46%
Canadian tax-exempt	0%	32%
Taxable U.S. investor (**)	15%	42%

(*) All rates in the table are as of 2011, include both entity- and investor-level tax (as applicable) and reflect already-announced rate reductions. Rates for "taxable Canadian" assume that top personal income tax rates apply and that provincial governments increase their dividend tax credit for dividends of large corporations.
(**) Canadian taxes only. U.S. tax will in most cases also apply.

As noted above, the pace of conversions of corporations into FTEs, in particular business trusts, has not abated. Since the Government has resolved the issue for Canadian-resident individuals, it can be concluded that the tax advantages still enjoyed by non-resident and tax-exempt investors in FTEs are now a driving force behind these conversions.

Provincial implications

In addition to delivering a federal tax advantage to certain investors, FTEs create two serious difficulties for Canada's provinces. First, to the extent they have non-Canadian investors, FTEs deplete overall provincial tax revenues even more significantly than they deplete federal revenue. This is because although federal non-resident tax applies to income that a foreign-resident investor earns through an FTE, that income is not subject to tax in any province. (In contrast, the dividends that a foreign-resident shareholder of a Canadian corporation receives are paid out of income that has already been taxed both federally and provincially.)

Second, to the extent an FTE's Canadian investors reside in provinces other than where the FTE itself operates, tax revenue is shifted between provinces. A corporation's home province ordinarily expects to be able to tax the corporation's earnings. But if the corporation becomes an FTE, that province may lose a large portion of the associated tax revenue; instead the provinces where the investor resides will get the tax, if any, on the distribution. Several provinces have expressed concerns about the impact this has on their economies and their tax revenues. For example, in its last Budget, the Province of Alberta estimated its net revenue loss as a result of income trusts to be about $400 million per year. The Government recognizes that it has a unique role in the federal-provincial tax environment, and has the responsibility to deal with these issues.

Other countries' experiences

Canada is not the only country that has faced issues around the tax treatment of FTEs and similar entities. Australia and the United States, for example, have tax systems broadly comparable to Canada's, and both have had to deal with the distortions that FTEs can cause. Although the particulars of the Australian and U.S. rules are necessarily unique, both have foreclosed the kind of inappropriate avoidance of entity-level tax that Canada's FTEs now exploit.

The Government's solution: continuing the Tax Fairness commitment

Given the difficulties FTEs cause, and faced with their accelerating growth, the Government has concluded that it must act. The Government will not address the tax issues around FTEs in isolation. Rather, it is proposing a package that continues its commitment to tax fairness for all Canadians.

With that commitment in mind, the Government plans a four-fold approach that combines a measured response to the tax imbalance created by FTEs while also providing meaningful tax relief to Canadian pensioners and seniors and businesses in Canada. The elements of this approach are as follows:

1. Changes to the tax treatment of FTEs and their investors

A more appropriate tax regime will be introduced for FTEs. Under this regime their tax treatment will be more like that of corporations, and their investors will be treated more like shareholders.

Specifically, certain distributions of FTEs' income will be subject to tax at corporate income tax rates. Those distributions will – like the dividends that corporations pay – not be deductible by an FTE that is a trust, and will be taxed in the hands of an FTE that is a partnership. The investors in the FTE will be taxed as though the distributions were dividends.

The FTEs that will be subject to these new rules will be fully defined in the legislation to implement these measures. As a practical matter, however, it can be assumed that the rules will apply to any publicly-traded "income trust" (or publicly-traded partnership), other than one that only holds passive real estate investments.

These changes will generally take effect beginning with the 2007 taxation year for trusts that begin to be publicly-traded after October 2006, but will only apply beginning with the 2011 taxation year for those FTEs that are already publicly-traded.

The measures will be effective in rebalancing the income tax treatment of FTEs. As a result, the legal form a given business takes – whether as a corporation, a trust or a partnership – will come to depend less on the peculiarities of the tax law, and more on the substantive business attributes of each of those structures.

The attached Technical Annex provides further detail on the new tax rules for trusts and partnerships.

Table 2 summarizes the effects of these changes.

Table 2: Simplified Comparison of Investor Tax Rates in 2011

	Current System		New System	
Investor	FTE (Income)	Large Corporation (Dividend)	FTE (Non-Portfolio Earnings)	Large Corporation (Dividend)
Taxable Canadian (*)	46%	46%	45.5%	45.5%
Canadian tax-exempt	0%	32%	31.5%	31.5%
Taxable U.S. investor (**)	15%	42%	41.5%	41.5%

(*) All rates in the table are as of 2011, include both entity- and investor-level tax (as applicable) and reflect already-announced rate reductions and the additional .5% corporate rate reduction described below. Rates for "taxable Canadian" assume that top personal income tax rates apply and that provincial governments increase their dividend tax credit for dividends of large corporations.

(**) Canadian taxes only. U.S. tax will in most cases also apply.

2. Corporate income tax reduction

The 2006 Budget announced that the general corporate income tax rate would be reduced from 21% to 19% by 2010. The Government will reduce the rate by a further one-half percentage point, to 18.5%, beginning in 2011. Table 3 sets out the general corporate income tax rates for 2007 to 2011, taking into account this change.

This will further enhance the competitiveness of Canada's corporate income tax system.

Table 3: Federal Corporate Income Tax Rates, 2007-2011

	2007	2008	2009	2010	2011
			(percent)		
General corporate income tax rate	21.0	20.5	20.0	19.0	19.0
Proposed rates	21.0	20.5	20.0	19.0	18.5

3. Age credit enhancement

The age credit, a special federal income tax credit for Canadians 65 years of age and older, will be significantly enhanced, with the increase taking effect retroactively to January 1, 2006.

The age credit is calculated by multiplying the lowest personal income tax rate by an amount that is indexed to inflation; for 2006, this amount is $4,066. The credit is subject to an income test that targets the assistance to seniors who need it most. The unused portion of the credit may be transferred to a spouse or common-law partner.

- For 2006, the age credit amount begins to be phased out when net income reaches $30,270. The phase-out rate is 15%, which means that the credit is fully phased out when net income reaches $57,377.

The amount on which the age credit is computed will be increased by $1,000 to $5,066, effective January 1, 2006. This increase will help low- and middle-income seniors by providing up to $155 ($152.50 for 2006) of federal income tax relief each year for those eligible to receive the credit.

- With this enhancement, the age credit will be fully phased out when net income reaches $64,043.

4. Pension income splitting

Canada's income tax system generally requires each individual taxpayer to report and pay tax on all of the income they earn. This is the case even if the individual, like many Canadians, actually uses much of their income to support other family members. The current system gives some limited relief for taxpayers in this situation, for example through tax credits for the support of a spouse or common-law partner or dependent children, but it still attributes the income itself exclusively to the person who earns it.

Recognizing the special challenges of planning and managing retirement income, and to provide targeted assistance to pensioners, this package includes a new mechanism for pension income splitting. The measure will allow any Canadian resident who receives income that qualifies for the existing pension income tax credit to allocate to their resident spouse (or common-law partner) up to one-half of that income. This measure will significantly increase the incentive to save and invest for family retirement security.

For individuals aged 65 years and over, eligible pension income includes lifetime annuity payments under a registered pension plan, a registered retirement savings plan or a deferred profit-sharing plan and payments out of or under a registered retirement income fund. For individuals under 65 years of age, eligible pension income includes lifetime annuity payments under a registered pension plan and certain other payments received as a result of the death of the individual's spouse or common-law partner.

For income tax purposes, the amount allocated will be deducted in computing the income of the transferor (the person who actually received the pension income) and included in computing the income of the transferee (the person to whom some or all of the pension income is allocated). Since it will in many cases increase the transferee's tax payable, both persons must agree to the allocation in their tax returns for the year in question.

The pension income splitting allocation will be available for the 2007 and subsequent taxation years, and must be made one year at a time.

This Plan will provide over $1 billion of new tax relief annually for Canadians.

Table 4 summarizes the impact of the proposed measures.

Table 4: Impact of Proposed Measures

	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	Total
	(millions of dollars)						
Tax Relief							
- Increase of the Age Credit	405	345	355	360	380	400	2,245
- Pension Income Splitting	165	675	710	745	780	820	3,895
- 0.5% General Corporate Tax Rate Reduction	0	0	0	0	180	725	905
Total	570	1,020	1,065	1,105	1,340	1,945	7,045
Revenue from Publicly-traded Flow-through Entities	0	0	0	0	-100	-400	-500
Total	**570**	**1,020**	**1,065**	**1,105**	**1,240**	**1,545**	**6,545**

Technical Annex

Current system: Taxation of flow-through entities

When a corporation pays a dividend to its shareholders, it usually does so using money that has already borne tax. The dividend will also be subject to tax in the hands of the shareholder. If the shareholder is an individual and is resident in Canada, the income tax system relieves the potential double taxation through the dividend "gross-up" and dividend tax credit mechanism.

In contrast to corporations, both trusts (optionally) and partnerships (automatically) are able to operate in such a way that they are not ordinarily subject to tax on the income they earn. For a trust, a distribution of income to the trust beneficiaries is required to remove the tax liability from the trust. For a partnership this effect is automatic: the members of the partnership, not the entity itself, are considered to earn the partnership income. In both cases, however, the existing income tax rules allow the entities themselves not to bear any tax liability, instead shifting to other persons all of the income tax burden associated with their operations – along, of course, with the income itself.

This tax difference between corporations on the one hand, and FTEs (both trusts and partnerships) on the other hand, stems from the different roles each structure has historically played. In particular, most sizable businesses in Canada – especially those that have raised capital through public markets – have traditionally been organized as corporations, while partnerships were generally smaller, owner-operated businesses and trusts

served a variety of mostly non-commercial and portfolio investment functions.

These conditions have changed: trusts and partnerships now operate in many business sectors, and investments in them can be publicly traded. Where this is the case, the role of the typical member or beneficiary is essentially the same as the role of a typical shareholder of a public corporation: that person is a passive investor.

In principle, the tax that an FTE does not pay is paid instead by those public investors, and there should be no tax reason for an investor to prefer FTE income to corporate dividends. This is indeed the case for taxable Canadian-resident individuals. In the past, the rates set under the dividend gross-up and dividend tax credit system meant that these individuals may have preferred FTE income. The 2006 Budget addressed that possibility by reducing the personal income tax rate payable on dividends of large corporations. This largely equalized the tax treatment of taxable Canadian investors' income from FTEs and their income from corporations.

However, the tax system still includes a bias in favour of investments in FTEs for two important categories of investors – tax-exempt investors and non-residents. The tax advantages for these investors is often a major consideration in a business's decision whether to organize (or reorganize) itself as an FTE, rather than as a corporation.

Canadian tax-exempt investors, such as Canadian pensions and RRSPs, are subject to tax neither on FTE income nor on dividend income. However, because dividends are paid out of income that in most cases has been taxed, the dividend income received by these tax-exempt investors has in effect borne tax, at a combined federal-provincial tax rate that will be about 32% after already-announced corporate rate reductions have fully taken effect. The absence of an equivalent tax on the earnings of an FTE means that these investors will generally prefer those earnings to dividends.

Non-resident investors also benefit from a lower rate of tax on income received from Canadian FTEs compared with the dividends of taxable Canadian corporations. For example, U.S. investors are subject to total Canadian tax of 15% on income received from Canadian publicly listed income trusts, compared with a combined tax rate of around 42% on dividends from large Canadian corporations.[2]

Table 5 shows the tax rates these investors pay on income from an FTE and dividend income

Table 5: Investor Tax Rates in 2011 (under the current system)

Investor	FTE (Income)	Large Corporation (Dividend)
Taxable Canadian (*)	46%	46%
Canadian tax-exempt	0%	32%
U.S. investor (**)	15%	42%

[2] All rates are as of 2011.

(*) Assumes the top personal income tax rate and that provincial governments increase their dividend tax credit for dividends of large corporations.

(**) Canadian taxes only. U.S. tax will in most cases also apply.

Proposal: Taxation of "specified investment flow-through" (SIFT) distributions

"Specified investment flow-through"

The proposed new rules are meant to apply to a clearly defined set of FTEs, to be known as "specified investment flow-throughs" or SIFTs. As a practical matter it can be assumed that all of the entities conventionally known as "income trusts" are SIFTs, as are any publicly-traded partnerships that hold significant investments in Canadian properties. The following description reflects the details that are expected to be included in the new statutory definition of "specified investment flow-through".

A trust (other than a real estate investment trust – see below) will be a SIFT throughout a taxation year if, at any time in the year, it satisfies all of the following conditions:

- The trust is resident in Canada;
- Units of, or other investments in, the trust are listed on a stock exchange or other public market[3]; and
- The trust holds one or more "non-portfolio properties".

A partnership will be a SIFT throughout a taxation year if, at any time in the year, it satisfies these conditions:

- The partnership meets one or more of the following residence-like criteria: it is a "Canadian partnership" (an existing defined term that describes a partnership all of the members of which are resident in Canada); its central management and control is located in Canada; it was formed under the law of Canada or a province; or it would, if it were a corporation, be resident in Canada;
- Units of, or other investments in, the partnership are listed on a stock exchange or other public market; and
- The partnership holds one or more "non-portfolio properties".

Non-portfolio properties will include certain investments in a "subject entity", Canadian resource properties, timber resource properties and real properties situated in Canada.

The main kinds of subject entity will be corporations resident in Canada, trusts resident in Canada, and partnerships that meet one or more of the residence-like criteria listed above. Non-resident corporations and trusts, and partnerships that otherwise would not meet this definition, may also be subject entities if their principal source of income is in Canada.

---

[3] Two points should be noted about this element. First, the concept of a public market is broader than just those stock exchanges that are prescribed for purposes of the *Income Tax Act*, and broader than even all stock exchanges. For example, an organized quotation system that supports over-the-counter trading is considered a public market for this purpose. Second, investments in the trust will for this purpose include securities of other issuers, if those securities derive all or substantially all of their value from securities issued by the trust.

An investment in a subject entity will be a non-portfolio property if it meets either (or both) of the following tests:

- *The investor holds a significant portion of the subject entity's value*: The investor holds securities of the entity that have a total fair market value that is greater than 10 percent of the entity's "equity value". For this purpose an entity's equity value is the fair market value of all of the issued and outstanding shares or interests in the entity.

- *Most of the investor's value is attributable to the subject entity*: The investor holds securities of the entity that, together with all of the securities that the investor holds of entities affiliated with the entity, have a total fair market value that is greater than 50 percent of the equity value of the investor itself.

Securities of an entity are to be viewed very broadly. They can be expected to include not only equity investments in the entity (shares, units, etc.) but also debts and other liabilities owing by the entity, rights to revenue or income, and options to acquire anything that would be a security of the entity. Provided adequate safeguards against abuse can be implemented, an exception may be made for liabilities and other obligations that arise in the normal course of the entity's business, such as trade payables.

An investor's Canadian resource properties, timber resource properties and real properties situated in Canada will be non-portfolio properties of the investor if the total fair market value of all such properties held by the investor is greater than 50 percent of the equity value of the investor itself. For this purpose, any property the value of which is derived principally from Canadian resource properties, timber resource properties or real properties situated in Canada will be treated as being itself a property of that type.

Lastly, any other property owned by the investor will be a non-portfolio property if the investor (or a person or partnership with which it does not deal at arm's length) uses the property in carrying on a business in Canada.

Real estate investment trusts

Certain trusts that would otherwise be SIFTs will be excluded from the SIFT definition. These are trusts (commonly known as real estate investment trusts or REITs) that meet a series of conditions relating to the nature of their income and investments. Those conditions are similar to the conditions that the United States applies to US real estate investment trusts, and like the US rules this exception from the SIFT measures recognizes the unique history and role of collective real estate investment vehicles.

To benefit from this exception (i.e. to be a REIT) for a given taxation year, a trust must:

- At no time in the year hold any non-portfolio property other than real properties situated in Canada;

- Have as not less than 95% of its income for the year income from properties (whether in Canada or abroad, and including dividends, interest, rents, etc. and taxable capital gains from dispositions of real properties);

- Have as not less than 75% of its income for the year income that is directly or indirectly attributable to rents from, mortgages on, or gains from the disposition of, real properties situated in Canada; and

- Hold throughout the year real properties situated in Canada, cash, and debt or other obligations of Governments in Canada (including Crown corporations, etc.) with a total fair market value that is

not less than 75% of its equity value.

For these purposes, "real property situated in Canada" will include securities issued by any entity that itself satisfies the above conditions. A REIT can thus hold its Canadian real properties either directly or through intermediary entities. "Real property situated in Canada" will not, however, include any depreciable property the capital cost allowance rate for which is greater than 5%.

Effects of being a SIFT trust

Under these proposals, a trust that is a SIFT (a "SIFT trust") will not be permitted to deduct, in computing its income for tax purposes, certain amounts that would otherwise be deductible. However, the trust will not pay tax on those amounts at the full tax rate that normally applies to undistributed trust income. Instead a special rate, based on the federal-provincial corporate income tax rate, will apply to the SIFT trust to the extent of its non-deductible distributions. As well, those amounts will be treated in the hands of the SIFT trust's beneficiaries as taxable dividends paid by a taxable Canadian corporation.

Non-deductibility

Under the existing law a trust can generally deduct in computing its income for a taxation year any amount of that income that it pays to a beneficiary in the year. The beneficiaries of a SIFT trust are ordinarily the investors in the trust, and since SIFT trusts are usually unit trusts, their investors are also unitholders. A SIFT trust can thus deduct its distributions of income and taxable capital gains to its unitholders.

This will be modified to prevent a SIFT trust from deducting any part of its distributions that is attributable either to a business it carries on in Canada or to income from – or capital gains on – non-portfolio properties. These amounts are referred to here as a SIFT trust's "non-portfolio earnings". The only exceptions in respect of non-portfolio earnings will be any taxable dividend that the trust could, if it were a corporation, deduct under the *Income Tax Act*.

More specifically, there will be excluded, from the amount that a SIFT trust can deduct, the total of:

- income from businesses it carries on in Canada;
- income (other than the dividends mentioned above) from its non-portfolio properties; and
- taxable capital gains from its dispositions of non-portfolio properties.

It is important to note that some SIFT trusts may distribute to their unitholders, either in addition to or instead of income, capital amounts. A "return of capital" is not deductible by the trust, and it is not included directly in the income of the unitholder. Instead, it reduces the unitholder's cost of their investment. These effects do not change under the proposed measures.

Reduced Tax Rate on Distributed SIFT Trust Earnings

Trusts are ordinarily taxed at the highest personal income tax rate of 29% federally, plus applicable provincial tax. This tax rate will be reduced, for non-portfolio earnings that a SIFT trust distributes to its beneficiaries (unitholders), to a rate that is equivalent to the federal general corporate tax rate, plus 13% on account of provincial tax. With the reductions already announced in the federal rate, and the further reduction that accompanies these measures, the tax rate for distributed non-portfolio earnings will be as shown in Table 6.

Table 6: SIFT Tax Rates: Distributed Non-Portfolio Earnings, 2007-2011

	2007	2008	2009	2010	2011
			(percent)		
Basic rate (federal)	21.0	20.5	20.0	19.0	18.5
Additional rate (in lieu of provincial tax)	13.0	13.0	13.0	13.0	13.0
Total	34.0	33.5	33.0	32.0	31.5

The distributed non-portfolio earnings of a SIFT trust will be excluded from the inter-provincial income allocation formula, meaning that provincial tax will not apply. However, the 13% portion applied on account of provincial tax will be collected and held for distribution to provinces based on a reasonable allocation, which the Government intends to work with the provinces to develop.

It should be emphasized that this special treatment – both the lower federal tax rate and the additional tax in lieu of provincial tax – will apply only in respect of those non-portfolio earnings that are distributed to a SIFT trust's beneficiaries. Amounts that are retained by the SIFT trust will continue to be taxed at the ordinary federal and provincial rates that apply to the taxable income of a trust. The retention of this existing difference between the taxation of trusts and the taxation of corporations is deliberate, and is consistent with leaving in place other differences such as the different treatment of returns of capital.

Dividend treatment

Any amount that becomes payable by a SIFT trust to a beneficiary of the trust, and that the trust is, as a result of these measures, prevented from deducting in computing its income, will be taxed in the hands of the beneficiary (the unitholder) as though it were a taxable dividend from a taxable Canadian corporation. (This deemed dividend will also be deemed to be an "eligible dividend" for purposes of the new enhanced dividend tax credit, if it is paid to a person resident in Canada.) The effects of this treatment will vary depending on who the unitholder is. In general terms, for example:

- An individual who is resident in Canada and is taxable on the distribution will apply the eligible dividend "gross-up" to the distributed amount, and may claim the eligible dividend tax credit to reduce the amount of personal tax the individual would otherwise have paid.

- A corporation resident in Canada may deduct the amount of the distribution from its income.

- A registered pension plan, a registered retirement savings plan (RRSP) or registered retirement income fund (RRIF) will not be taxed on the distribution. (For these unitholders the treatment of the distribution as a dividend has no direct effect).

- A unitholder who is non-resident will be taxed on the distribution at the non-resident "withholding tax" rate for dividends, taking into account any rate reduction provided, under an applicable tax treaty, for cross-border dividends. For instance, a United States pension or other retirement ar-

rangement (such as an IRA) will, under the Canada-US Income Tax Convention, be exempt from the Canadian tax that would otherwise apply to the distribution, just as it would be if it received a dividend.

Effects of being a SIFT partnership

Under the existing tax law, partnerships are not subject to income tax. Rather, the income earned and losses incurred by a partnership are calculated at the partnership level and allocated to the members of the partnership in accordance with their respective interests.

Under these proposals, a partnership that is a SIFT will be required to pay a tax on the total of its:

- income from businesses it carries on in Canada;
- income from its non-portfolio properties (other than dividends that would, if it were a corporation, be deductible in computing its taxable income); and
- taxable capital gains from its dispositions of non-portfolio properties.

As with SIFT trusts, the tax rate will be set at a rate equal to the federal corporate tax rate, plus 13% on account of provincial tax. The amount collected on account of provincial tax will be held for distribution to provinces based on a reasonable allocation, which the Government intends to work with the provinces to develop.

Dividend treatment

Partnership income that is subject to the new tax will be treated as dividends. Specifically, partnership allocations, up to the amount that is subject to the tax at the partnership level, may be recharacterized, in the hands of the members of the partnership and in the same proportion as their allocations of incomes and losses otherwise determined, as taxable dividends from a taxable Canadian corporation. (This deemed dividend will also be deemed to be an "eligible dividend" for purposes of the new enhanced dividend tax credit if it is paid to a person resident in Canada.)

Anti-avoidance

The details outlined in this document reflect the present intentions of the Government. These details are, however, subject to change in order to ensure that they meet the policy objectives that underlie them. In particular, if there should emerge structures or transactions that are clearly devised to frustrate those policy objectives, any aspect of these measures may be changed accordingly and with immediate effect.

Effective Date

The changes announced today will not apply to SIFTs that began to be publicly traded before November 2006 – or their investors – for taxation years that end before 2011. This transitional delay in implementing the new rules is subject to the possible need to foreclose inappropriate new avoidance techniques. For example, while there is now no intention to prevent existing SIFTs from normal growth during that transitional period, any undue expansion of an existing SIFT (such as might be attempted through the insertion of a disproportionately large amount of additional capital) could cause this to be revisited.

For SIFTs that begin to be publicly traded after October 2006, the changes announced today will apply for the later of their 2007 taxation year and the taxation year in which they begin to be traded.

October 31, 2006

Statement by the Honourable Jim Flaherty, Minister of Finance

Ottawa, Ontario

Check against delivery

Good evening:

I am here tonight to announce our new Tax Fairness Plan for Canadians. It's a plan designed to level the playing field between income trusts and corporations.

The measures I am bringing forward today are necessary to restore balance and fairness to Canada's Tax System. They are necessary to ensure our economy continues to grow and prosper. They are necessary to bring Canada in line with other jurisdictions throughout the world.

Our plan is the result of months of careful consideration and evaluation. Our actions are clear, decisive and in the best interest of all Canadians.

Despite the provisions in Budget 2006 to reduce the level of taxation on corporate dividends, the landscape has changed dramatically in the short time I have been Minister of Finance. This year alone there has been almost $70 billion in new trust announcements.

We have seen a growing trend towards corporate tax avoidance. Top Canadian corporations, operating within the current rules, have announced their intention to convert to income trusts. They feel compelled to seek more favourable tax treatment by capitalizing on an available tax rule.

This trend has now moved into the core of our industrial and knowledge-based economy. It is a trend that has caused me growing concern. If corporations don't pay their share of taxes, this tax burden will shift onto the shoulders of hardworking individuals and families.

This is simply not fair.

This trend towards income trusts is also creating an economic distortion that is threatening Canada's long-term economic growth. It is limiting the ability of Canadian capital-intensive corporations to invest, to grow and compete in this highly competitive global economy.

If we continue down this road the implications for Canadians are significant. We will find ourselves with a tax system that is less fair and an economy that is less productive and competitive. Left unchecked such corporate decisions would result in billions of dollars in less revenue for the federal government to invest in the priorities of Canadians, including more personal income tax relief. These decisions would also mean less revenue for the provinces and territories, several of which have made representations to me on this matter.

Clearly, Canada is out of step in its treatment of income trusts. The structure being used in this country was shut down in the United States and Australia.

This situation is not right and it is not fair. It is the responsibility of the Government of Canada to set our nation's tax policy, not corporate tax planners.

In response, I am putting forward our government's Tax Fairness Plan:

First of all, the government is proposing to apply a Distribution Tax on distributions from publicly traded income trusts. This will level the playing field between trusts and corporations.

For income trusts that begin trading after today, these measures will apply beginning with their 2007 taxation year. For existing income trusts the government is proposing to provide a four-year transition period. They will not be subject to the new measures until their 2011 taxation year.

Secondly, as part of our Tax Fairness Plan we will be reducing the general corporate income tax rate one-half percentage point as of January 1, 2011. As a result of this measure, there will not be more government revenue generated from the corporate sector.

Thirdly, we are increasing the Age Credit Amount by $ 1,000 from $4,066 to $5,066 effective January 1, 2006. This measure will provide tax relief for low and middle-income seniors.

Finally, we are introducing a major positive change in tax policy for pensioners. We will permit income splitting for pensioners beginning in 2007. This will significantly enhance the incentives to save and invest for family retirement security.

We recognize that pensioners and seniors have made important investments over the years and may be receiving benefits from the current income trust structure. These two measures will allow them to retain more of their income in their retirement years. This is a significant step forward in the strengthening of our social security system for pensioners and seniors.

These measures will enhance the seniors' initiative we introduced in Budget 2006. At that time we doubled the amount of eligible pension income that can be claimed under the pension income credit – from $1,000 dollars to $2,000 starting in the 2006 tax year.

Our government firmly believes tax relief is one of the keys to ensuring the Canadian economy remains strong and competitive. I will have more to say about our competitiveness when I present the government's Fall Economic Statement and release our Economic Plan for Canada in the next few weeks.

These measures represent a major tax reduction. Our Tax Fairness Plan will deliver over a billion dollars of new tax relief annually for Canadians. The initiatives I am announcing today clearly build on our tax relief package outlined in Budget 2006. We delivered significant tax relief for Canadians with 29 tax cuts amounting to $20 billion in tax relief over the next two years.

But more needs to be done.

Families and businesses still pay too much tax in this country, and our government will continue to reduce the tax burden on Canadians. At the same time, we must ensure that no one gains an unfair tax advantage at the expense of others. It's a responsibility we cannot and will not abdicate.

Each and every day Canadians across the country get up and go to work, pay their taxes and set aside a few dollars for retirement. They trust that their government is watching out for them and upholding the values that make our country great. The values that define us as Canadians, like fairness.

The Tax Fairness Plan I am announcing today will uphold the value of fairness.

- It will level the playing field between income trusts and corporations;
- It will ensure that taxes are not unfairly shifted onto the shoulders of Canadian families and taxpayers;
- It will strengthen Canada's social security system for pensioners and seniors;
- It will help corporations make choices that are consistent with economic growth and competitiveness; and
- It will bring Canada's approach to income trusts back in-line with other jurisdictions.

Canada's New Government understands that good government and good policy are about being focused, determined and decisive. Our Tax Fairness Plan is not only the right thing to do, it is in the best interest of all Canadians from coast to coast to coast.

Thank you.